

CLPs to resell to its customers as well. He stated that although the Act only requires BellSouth to provide white page listings, BellSouth has arranged with its affiliate, BellSouth Advertising and Publishing Company ("BAPCO") to provide CLPs' business subscribers' listings in the appropriate Yellow Pages or local classified directories as well. He further stated that all interconnection agreements which BellSouth has negotiated with resellers and facilities-based carriers have included arrangements for the provision of directory listings in the white pages.

AT&T witness Hamman testified that AT&T does have white page listings for their resale customers in Georgia. Both witness Hamman and AT&T witness Bradbury testified, however, that in their opinions BellSouth had not met a single checklist item because the operational support systems underlie virtually every checklist item, and BellSouth does not have the operational support systems in place to provide the checklist items in a nondiscriminatory manner. The Commission has found under checklist item II, however, that BellSouth is providing or generally offering CLPs nondiscriminatory access to its operational support systems.

Based on the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering white pages directory listings for customers of the other carrier's telephone exchange service and is in compliance with checklist item VIII.

ITEM IX. BellSouth is providing or generally offering nondiscriminatory access to telephone numbers for assignment to the other carrier's telephone service customers.

BellSouth addresses this item in Section IX of its SGAT. This section states that BellSouth is the North American Numbering Plan administrator for its territory and that, while it continues to serve as the numbering plan administrator, it ensures that both facilities-based or reseller CLPs have nondiscriminatory access to telephone numbers for assignment to their customers under the same terms that BellSouth has access to telephone numbers. BellSouth also agrees that when it is no longer the North American Numbering Plan administrator, it will comply with the final and nonappealable guidelines, plan or rules adopted pursuant to 47 U.S.C. 251(e).

BellSouth witness Milner testified that BellSouth is ensuring that CLPs have nondiscriminatory access to telephone numbers for assignment to their customers, and that BellSouth has established the procedures to provide nondiscriminatory NXX code assignments to CLPs. According to Mr. Milner, as of June 24, 1997, BellSouth had assigned a total of 108 NPA/NXX codes for CLPs in North Carolina, and 495 NPA/NXX codes for CLPs in the nine-state region.

BellSouth witness Vamer testified that BellSouth will provide numbering resources, pursuant to the Bellcore Guidelines, regarding number assignments. He also testified that at the time the FCC creates or designates numbering administrator(s), BellSouth will comply with the final and non-appealable guidelines, plan or rules adopted pursuant to Section 251(e) of the Act which addresses this creation or designation. He stated that, in

his opinion, BellSouth provides nondiscriminatory access to telephone numbers as required by the Act.

AT&T witness Hamman testified that BellSouth has not demonstrated that it is providing telephone numbers in accordance with the requirements of checklist item IX because methods and procedures for assignment of telephone numbers in place that apply equally to everyone, including BellSouth, must be established, and these methods and procedures do not exist. Mr. Hamman's testimony is in direct contradiction to Mr. Milner's testimony that BellSouth has established procedures. On cross-examination by the Attorney General, Mr. Hamman admitted that, other than in its interconnection agreement, AT&T has not asked for and thus has no first hand knowledge of whether they would be provided access to telephone numbers by BellSouth in North Carolina.

AT&T witness Bradbury focused in his testimony on the lack of OSS functions which BellSouth has to enable it to assign telephone numbers in a nondiscriminatory manner. According to Mr. Bradbury, BellSouth's OSS mechanism called LENS operates in two modes - "Inquiry" and "Firm Order." Mr. Bradbury asserted that the Firm Order Mode is not a commercially viable option to new entrants submitting EDI or fax orders and offered an example concerning the assignment of telephone numbers. According to Mr. Bradbury, a new entrant cannot reserve a number in the Firm Order Mode for an EDI or fax order, because the selected telephone number is released as soon as the new entrant aborts a particular LENS order. He stated that LENS apparently considers a telephone number to be "reserved" for some unknown period of time after it displays that number in response to a number search. When a new entrant actually selects a telephone number (in contrast to just viewing the number), LENS does not transform that telephone number from "reserved" status to "selected" status until the service order with that telephone number is entered into BellSouth's Service Order Completion System ("SOCS"). Mr. Milner stated that it could take minutes or days for a service order to be entered into SOCS, while, in contrast, BellSouth deems a telephone number to be "selected" instead of "reserved" when BellSouth itself chooses a telephone number using its own OSS." In addition, Mr. Bradbury stated that LENS does not provide new entrants with the same capability to reserve telephone numbers for CLPs as it does for BellSouth. He stated that BellSouth can use its OSS to reserve more types of telephone numbers than a new entrant using LENS. BellSouth can also reserve multi-line hunt group numbers while new entrants cannot, and that a new entrant will incur charges for conducting searches whereas BellSouth will not incur charges for conducting the same searches. Mr. Bradbury also stated that LENS is unable to perform certain telephone number searches as advertised, and that it does not provide new entrants with the same options as BellSouth for selecting telephone numbers.

On cross-examination by BellSouth, Mr. Bradbury admitted that AT&T does not intend to use interfaces offered through the SGAT except to the extent that those are the same interfaces available through AT&T's interconnection agreement with BellSouth. He also agreed that AT&T only intends to use the LENS system on an interim basis for preordering functions, of which assigning telephone numbers is included, until AT&T's own

long-term interfaces are delivered to AT&T in December. He admitted that he could not say that AT&T would be in the North Carolina local exchange market prior to December.

MCI witness Martinez testified that BellSouth is not making available or providing access to telephone numbers on a nondiscriminatory basis in accordance with the requirements of checklist item IX, because there are not standards in place for the assignment of NXXs with performance measures to insure that these standards are being met. Mr. Martinez asserted that when MCI NXX codes are loaded into the switches of all third parties, voids are created which prevent customers of MCI from receiving calls from customers of third parties whose providers do not have the codes loaded. He testified that it was MCI's belief that BellSouth should notify the industry regarding new NXX codes being assigned to MCI and open them up for MCI just as they do for themselves. In addition, Mr. Martinez stated MCI's belief that, to reduce the possibility of discrimination, there is a need to take steps to conserve the use of numbers; that it is BellSouth's responsibility to take steps to reduce the likelihood of exhaust; and that until BellSouth does so, it should not be deemed to satisfy its obligations under this checklist item. Mr. Martinez, however, admitted in his own direct testimony that BellSouth has the same problems with voids in its own networks where MCI's NXX codes have not been properly loaded. Furthermore, in his summary, Mr. Martinez did not include item IX among the checklist items which, he said, BellSouth should not be deemed to be making available OSS systems because its OSS systems have failed to meet the nondiscrimination requirement.

In addition, Mr. Milner testified that BellSouth does have standards in place regarding the assignment of NPA/NXX codes. He stated that BellSouth uses the Central Office Code (NXX) Assignment Guidelines for administering CO codes. He also stated that BellSouth maintains and updates the list of NPA NXX code assignments in its Local Exchange Routing Guide and, therefore, notifies the industry regarding new NXX codes being assigned to MCI.

Under questioning by Commission Chair Sanford, Mr. Martinez admitted that MCI was not having problems getting assigned numbers by BellSouth, but only in the activation of those numbers. He stated that it was his hope that this activation problem would go away when BellSouth ceased to be the administrator.

Based on the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering to CLPs nondiscriminatory access to telephone numbers for assignment to the other carrier's telephone exchange service customers and is in compliance with the requirements of checklist item IX.

ITEM X. BellSouth is providing or generally offering non-discriminatory access to databases and associated signaling necessary for call routing and completion.

BellSouth witness Milner testified that Section 10 of the SGAT provides access to the signaling elements necessary for call routing and completion, including Signaling Links, Signal Transfer Points ("STPs"), and Service Control Points ("SCPs"). The SCPs/Databases to which CLPs have access include, but are not limited to Toll Free Number Database, Line Information Database ("LIDB"), Advanced Intelligent Network ("AIN") databases, and Signaling Transport Service. Mr. Milner stated that the signaling elements necessary for call routing and completion are functionally available from BellSouth and that BellSouth has technical service descriptions outlining access to its 800 database, LIBD, and AIN services as well as access to BellSouth's signaling services. BellSouth also has procedures in place for the ordering, provisioning, and maintenance of these services.

BellSouth witness Varner testified that BellSouth's SGAT provides for access to the following components: Signaling Links; STPs and SCPs (database). Mr. Varner stated that signaling link transport is a set of two or four dedicated 56 kbps transmission paths between CLP designated Signaling Points of Interconnection ("SPOI") that provides appropriate physical diversity and a cross-connect at a BellSouth STP site. STPs provide the functionality that enables the exchange of Signaling System 7 ("SS7") messages between switching elements, database elements, and STPs. STPs provide access to other network elements connected to BellSouth's SS7 network including: (1) BellSouth provided Local Switching or Tandem Switching, (2) BellSouth provided SCPs/Databases, (3) Third-Party provided Local Switching or Tandem Switching, and (4) Third-party provided SCP/Databases. Mr. Varner also presented a full discussion of how BellSouth has made access available for the CLPs to BellSouth's Signaling Link Transport, Line Information Database, Toll Free Number Database, Automatic Location Identification/Data Management System, Advanced Intelligent Network Access, Service Creation Environment and Service Management System ("SCE/SME") Advanced Intelligent Network Access. Mr. Varner also listed the rates for its signaling/database services.

AT&T witness Hamman testified that in his opinion BellSouth has not demonstrated that it is providing signaling and databases in accordance with checklist item 10. His primary concern was that there has not been cooperative testing done of the access that BellSouth is providing to these signaling links and databases. Before testing can start, however, he stated that the parties must first agree on the testing process. He stated that once the testing process is established and operational information is gathered, then BellSouth and the CLPs will have the information needed to determine if there are still problems to be resolved.

MCI witness Martinez testified that BellSouth is not making available or providing non-discriminatory access to its databases. He stated that BellSouth is not providing

comprehensive access to its 800 databases but only limited access to the 800 Service Management System ("SMS"). Such access, he asserted, does not provide a new entrant with access to BellSouth's STPs for access to the BellSouth SCPs for the sole purpose of providing a new entrant the ability to do its own look-up on 800 traffic. No procedures exist today for the provisioning or billing of these network elements. He said that there was also an issue relative to availability of common channel signaling involving call return. In Mr. Martinez's opinion, there is no reason why call return should not be made available to a new entrant.

Mr. Milner responded in rebuttal that Mr. Martinez had questioned whether BellSouth could provide three specific types of access to a CLP to BellSouth's Toll Free Number Database. He stated that in each of these cases BellSouth offers this type of interconnection or could provide such access upon request. Mr. Milner also rebutted Mr. Hamman's assertion that BellSouth has not provided the methods and procedures for CLPs to access BellSouth's signaling systems and databases. He stated that one CLP is already directly accessing BellSouth's signaling network and call related databases while seven other CLPs have access through third party "hub providers."

Based on the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering nondiscriminatory access to its databases and associated signaling systems necessary for call routing and completion and is in compliance with checklist item X.

ITEM XI. BellSouth is providing or generally offering interim telecommunications number portability through remote call forwarding, direct inward dialing trunks, or other comparable arrangements with as little impairment of functioning, quality, reliability, and convenience as possible.

Number portability is a service arrangement that allows customers to retain, at their same location, their existing telephone numbers when switching from one telecommunications carrier to another carrier. In Section XI of its SGAT, BellSouth offers Remote Call Forwarding ("RCF") and Direct Inward Dial ("DID") as two forms of number portability, both of which are acceptable forms of interim number portability under this checklist item. It is BellSouth's position, therefore, that it is in compliance.

BellSouth witness Varner testified that the FCC issued regulations regarding number portability on July 2, 1996, in the First Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 95-116 ("Order No. 96-286"). In that Order, the FCC found that currently available number portability measures should be provided until a long-term method is technically feasible and available. The order established guidelines that LECs must meet when selecting long-term portability methods. The FCC did not specify a particular technology for providing number portability in the interim, but the Order describes Remote Call Forwarding and Direct Inward Dial as the only methods technically feasible.

Mr. Varner described the provisions for interim portability in BellSouth's SGAT. He stated that BellSouth can provide interim number portability through several methods such as RCF, DID, Route Index Portability Hub ("RI-PH") and local exchange routing guide ("LERG") reassignment to the NXX level. BellSouth, according to Mr. Varner, envisions that CLPs using the SGAT would typically utilize RCF and possibly DID; therefore, rates are included in the SGAT for these arrangements. Other methods of providing interim number portability are available through the Bona Fide Request process.

Mr. Varner explained that RCF is an existing switch-based BellSouth service that redirects calls within the telephone network by translating the dialed number to a new number. For DID, BellSouth routes the call over a dedicated facility to the CLP's switch, instead of translating the dialed number to a new number. RCF and DID, according to Mr. Varner, are generally accepted by the industry as the *de facto* standard for interim service provider number portability. He stated that these methods meet the requirements of the Act until a permanent long-term number portability capability is fully developed, tested, and implemented by the industry. He also discussed BellSouth's rates for RCF and DID.

BellSouth witness Milner testified that interim number portability is functionally available from BellSouth. BellSouth has technical descriptions outlining RCF and DID and has procedures in place for ordering, provisioning, and maintaining these services. Mr. Milner stated that as of July 8, 1997, BellSouth has ported 124 business directory numbers in North Carolina using interim number portability and 7,401 numbers in its region. He further stated that local service subscribers in BellSouth's region dial the same number of digits to place a local call, without the use of an access code, regardless of their choice of local service provider.

AT&T witness Hamman testified that BellSouth has not complied with this checklist item. He stated that AT&T requested in negotiations with BellSouth, and BellSouth agreed, to provide RI-PH as the interim number portability solution for customers with large quantities of telephone numbers in North Carolina. RCF and DID are not, in AT&T's opinion, sufficient to address the needs of these customers. He emphasized that retaining their existing telephone numbers through an interim number portability solution that is invisible to the end user is extremely important to these companies. If RCF and DID are the only available means for interim number portability, Mr. Hamman predicted that a large number of these customers with large quantities of numbers will likely refuse to switch to a CLP until a permanent number portability solution becomes available.

In response to Mr. Hamman, Mr. Milner stated that RI-PH is an extrapolation of the direct inward dial method of service provider number portability ("SPNP"), where the intercompany traffic is delivered from a "hub" location, typically the access tandem, rather than from each local switching office. As with the DID method, when a telephone call is placed to a ported number, the receiving local switching office analyses all seven digits of the dialed number and determines that the call should be transferred to another local service provider's switch. According to Mr. Milner, RI-PH is technically feasible and can be implemented as requested by the CLP. BellSouth simply believes that CLPs who elect

to use the SGAT, rather than negotiating individual interconnection agreements, will not normally have a desire for RI-PH. If a CLP requests such service, BellSouth will provide it.

MCI witness Martinez testified that, while BellSouth does offer RCF as an interim solution, it was his understanding that MCI was experiencing significant problems with cutovers. He stated that the BellSouth-MCI contract provides that on a coordinated cutover BellSouth should not begin the cutover until more than twenty minutes after the agreed upon time. Despite the language of the contract, BellSouth has offered cutovers within a four hour window, two hours before or two hours after the desired cutover time. Because of BellSouth's cutting customers over to MCI before MCI is ready to handle these new customers (e.g., before MCI has configured its switch for these new customer), certain of MCI's new customers have had their service interrupted. Mr. Martinez said that such interruptions in service could have been avoided if BellSouth had followed MCI's instruction not to cut a customer over to MCI until more than twenty minutes after the agreed upon time.

Mr. Milner disagreed with Mr. Martinez's assertion that BellSouth was prematurely cutting customers over to MCI and causing service interruptions. He stated that as part of an unbundled loop installation, BellSouth will coordinate implementation of SPNP with the loop installer. This coordination requires that BellSouth make a switch translation change, referred to as a "recent change," to the customer's line. It is this "recent change" that places the remote call forwarding on that customer's telephone number. Once the BellSouth technician has entered the recent change request into the system, that request is queued with many other changes that are routinely made to the switch's translation or memory. Once a request to enable call forwarding has been made, the "recent change" process will respond to that request. Should MCI request a postponement too late in the process, the "recent change" transaction will complete and the situation that Mr. Martinez described will occur. The problem is not with BellSouth's handling of MCI's request for a cutovers, but that MCI is not ready for the cutover (e.g., due to MCI's delay) or notifies BellSouth too late in the cutover process.

Sprint witness Closz testified about number portability translation errors that BellSouth made in Florida which caused service interruptions to several of SMNI's customers in the Orlando area. On three separate occasions, translation errors made by BellSouth interrupted local portability functionality, such that SMNI customers could receive calls directly to their Sprint numbers, but calls being call-forwarded through the BellSouth network could not be completed. She stated that these translation errors have been corrected but that the underlying permanent process correction is still being addressed.

Mr. Milner testified that Ms. Closz correctly noted that the translation errors have been corrected. He went on to state that corrective action has been taken to fix the situation. The remedy is to have a special message displayed to BellSouth's technicians who attempt to make changes to a special field called a Simulated Facilities Group ("SFG"). The message notes the criticality of the correct setting for this field and requires

the BellSouth technician to affirm his or her intent to proceed with a change. In addition, BellSouth's technicians have been given special training on making these translation changes.

Based on the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering interim telecommunications number portability through RCF, DID trunks, or other comparable arrangements with as little impairment of functioning, quality, reliability, and convenience as possible and is in compliance with checklist item XI.

ITEM XII. BellSouth is providing or generally offering non-discriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of Section 251(b)(3).

BellSouth witness Varner testified that the local dialing parity covered by this checklist item creates an environment where local service subscribers dial the same number of digits without the use of an access code to place a local call regardless of their choices of local service provider. For example, BellSouth's customers in some local calling areas dial either a 7- or 10-digit number to make local calls. With local dialing parity, CLP customers will likewise be able to dial a 7- or 10-digit number to make local calls. Mr. Varner stated that the CLP's switch ultimately determines how the CLP's end users dial specific calls. BellSouth, however, will interconnect with the CLP such that identical 7- and 10-digit dialing is possible. He said that there are no explicit charges for dialing parity. Because BellSouth and CLPs can use the same dialing and numbering plans, local dialing parity simply happens as CLPs begin operating.

BellSouth witness Milner testified that checklist item XII requires that BellSouth generally offer nondiscriminatory access to such services or information as necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of Section 251(b)(3) of the Act. Mr. Milner stated that BellSouth's SGAT addresses local dialing parity in Section XII and that BellSouth provides nondiscriminatory access to such services or information as necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of the Act. Local service subscribers in BellSouth's region, he stated, dial the same number of digits to place a local call, without the use of an access code, regardless of their choice of local service provider. This environment satisfies the local dialing parity requirement.

AT&T witness Hamman and MCI witness Martinez testified that BellSouth is not providing dialing parity. Mr. Martinez stated that an MCI customer calling MCI Directory Assistance and wishing access to Directory Service Listings for independent telephone companies and other new entrants would need to be transferred by MCI's Directory Assistance to BellSouth's Directory Assistance or such customer would have to dial a special code to by-pass MCI's Directory Assistance and go directly to BellSouth's Directory Assistance. In Martinez's opinion, this is not dialing parity.



In rebuttal, Mr. Milner stated that the issue is whether a local service provider can request that its directory listings not be provided to MCI by BellSouth. BellSouth believes that local service providers have that right and will honor requests not to provide such listings. Should MCI request that BellSouth not make MCI's customer listings available to others, BellSouth would likewise honor MCI's request. He further stated that BellSouth makes the listings of its customers available to all other local providers and also makes available the customer listings of all other service providers which have not specifically instructed BellSouth not to furnish their listings to others. Thus, this is an issue between MCI and certain local service providers rather than an issue between MCI and BellSouth.

Based upon the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering nondiscriminatory access to such services and information as necessary to allow requesting carriers to implement local dialing parity in accordance with the requirements of Section 251(b)(3) and is in compliance with checklist item XII.

ITEM XIII. BellSouth is providing or generally offering reciprocal compensation arrangements in accordance with the requirements of Section 252(d)(2).

BellSouth witness Varner testified that the standard for just and reasonable prices for reciprocal compensation is that each carrier receives mutual and reciprocal recovery of costs associated with the transport and termination on each carrier's facilities of calls that originate on the network facilities of the other carrier. The costs are to be based on a reasonable approximation of the additional costs of terminating such calls. As described under checklist item II, BellSouth offers cost-based rates for interconnection and reciprocal transport and termination at a tandem and at an end office.

BellSouth witness Milner testified that this item is not specifically addressed in the 85 binders because it is not an offering per se but an arrangement worked out between the parties.

Intermedia witness Strow testified that Intermedia was recently notified by BellSouth of its intent not to compensate Intermedia for transporting and terminating local traffic to Internet service providers ("ISPs"). According to Ms. Strow, the reciprocal compensation provision of the BellSouth-Intermedia interconnection agreement does not place any limitation on the type of local traffic for which reciprocal compensation would apply. She stated her belief that this action is tantamount to a breach of the reciprocal compensation and dispute resolution portions of the agreement and constitutes bad faith on the part of BellSouth. The immediate effect on Intermedia, she said, is that it would not be able to recover its costs associated with the transport and termination of local traffic to ISPs; the overall effect is that BellSouth stands to reap anticompetitive benefits. BellSouth Strow Cross Examination Exhibit 2 was a copy of a letter dated August 12, 1997, advising CLPs of BellSouth's position. It states in part:

The purpose of this letter is to call to your attention that our interconnection agreement applies only to local traffic. Although enhanced service providers (ESPs) have been exempted from paying interstate access charges, the traffic to and from ESPs remains jurisdictionally interstate. As a result, BellSouth will neither pay, nor bill, local interconnection charges for traffic terminated to an ESP. . . . The ESP category includes a variety of service providers such as information service providers (ISPs) and internet service providers, among others.

Ms. Strow stated on cross examination that this is an industry issue.

AT&T/MCI witness Cabe testified that at a minimum terms and conditions for the mutual and reciprocal recovery of call transport and termination must be established that do not provide a competitive advantage to either party. He stated that such an outcome can be assured if the compensation arrangement focuses on the function being performed rather than the simple labeling of the point of interconnection of other extraneous variables. In addition, Dr. Cabe stated, terms and conditions for the mutual and reciprocal recovery of costs of call transport and termination must be established that do not reward incumbent carriers for network inefficiencies they may experience relative to new entrants or punish new entrants for efficiencies they may experience relative to incumbents. An improper focus on configurations instead of functions can lead to undesirable consequences that can result in higher prices to consumers. Finally, he stated that cost-based rates for call termination and transport have not been developed for North Carolina.

KMC witness Menendez also addressed the issue raised by Ms. Strow. He stated that BellSouth's position is wholly inconsistent with the Act and FCC orders as well as a number of state regulatory decisions which have rejected ILEC attempts to withhold reciprocal compensation payments for the termination of ISP traffic or to treat traffic to enhanced service providers including ISPs differently than other local service. He stated that BellSouth is seeking to create a competitive disadvantage for new entrants by eliminating their ability to recover their fundamental cost of terminating local traffic to ISP customers pursuant to their interconnection agreements with ILECs while ILECs continue to charge their end user customers for the ability to place a call to an ISP.

In rebuttal, Mr. Varner contended that enhanced service provider traffic is jurisdictionally interstate because it does not terminate on the CLP's local facilities but rather traverses them as well as those of the ISP and the Internet transport providers to establish a communications path to distant Internet locations. He stated that the FCC has already exercised its jurisdiction over Internet traffic as evidenced by the fact that it granted an exemption from the payment of access charges to enhanced service providers. He further stated that this exemption applies only to ILECs; a CLP is free to charge appropriate rates to compensate it fully for any services it provides to ISPs. Finally, Mr. Varner stated, the FCC made it clear in its Local Interconnection Order that reciprocal

compensation rules apply only to traffic that originates and terminates within a local area. On cross examination by counsel for Intermedia, Mr. Varner stated that the fact that this traffic is interstate was established at least thirty years ago. He did not agree that the nature of the traffic is currently being litigated before the FCC. The issue that is being litigated, he said, is the rates the FCC should require information service providers to pay. As to whether BellSouth would be in violation of the checklist because of its refusal to pay reciprocal compensation if a court or the FCC or a state commission should find against BellSouth on this issue, Mr. Varner stated that this would be the rule from that point forward but that the rule today is that it is interstate traffic. As to whether, if BellSouth's argument is correct, it is illegally providing interstate service through its ISP subsidiary, BellSouth.Net, Mr. Varner stated that what is being provided through the subsidiary is Internet access, which is permitted under the Act.

Section XII of the SGAT states that "BellSouth provides for the mutual and reciprocal recovery of the costs of transporting and terminating local calls on its and CLP networks." The Commission has already concluded that the charges for transport and termination are cost based as required by the Act. As the evidence shows, however, an issue has arisen between BellSouth and CLPs with whom it has interconnection agreements as to whether ESP traffic is local traffic. The Commission believes this issue, which issue could also arise under the SGAT, is a complicated one and deserves further scrutiny in a separate proceeding.

Based on the evidence presented, the Commission concludes that BellSouth is providing or generally offering reciprocal compensation in accordance with the requirements of Section 252(d)(2) and is in compliance with checklist item XIII.

ITEM XIV. BellSouth is providing or generally offering telecommunications services for resale in accordance with the requirements of Sections 251(c)(4) and 252(d)(3).

BellSouth witness Varner testified that a retail service is a telecommunications service currently offered by BellSouth that is described in and offered through a BellSouth tariff to non-telecommunications service providers. In Section XIV of its SGAT, BellSouth offers its tariffed retail telecommunications services for resale subject to the applicable terms and conditions contained in its retail tariffs. The SGAT prohibits cross-class selling, resale of promotions of 90 days or less, resale of grandfathered or obsolete services to a different group or a new group of customers, and resale of CSAs entered into before April 15, 1997. Lifeline or Link-Up services are subject to resale only to eligible subscribers. N11 is not subject to resale, because it is not a retail offering.

Mr. Varner stated that the CLP will be the customer of record for all services purchased from BellSouth and, except as specified in the SGAT, BellSouth will take orders from, bill, and expect payment from the CLP for all services. The CLP will also be BellSouth's sole point of contact for all services purchased pursuant to the SGAT, including

ordering activities and repair calls. Thus, BellSouth will accept PIC changes from the CLP as the customer of record as well as from the IXC.

Mr. Varner further stated that the prices for resold services in the SGAT reflect the wholesale discount rates of 21.5 percent for residential services and 17.6 percent for business services set by the Commission's December 23 arbitration orders. Furthermore, he stated that BellSouth has negotiated a number of resale-only agreements with CLPs and resale of service provisions as part of many facilities-based agreements.

The process for ordering and provision of services purchased from the SGAT for resale purposes is set forth in the Resale Ordering Guide. In addition, BellSouth has provided electronic interfaces to support preordering, ordering, provisioning, trouble reporting, and billing functions. The CRIS format will be used initially to render bills, but BellSouth will modify its billing regionwide so that CRIS billing for resold services will be available in the CABS format in July for some parties.

Mr. Varner stated that BellSouth is prepared to accept orders from CLPs under the SGAT once it is approved or allowed to take effect. He further stated that the majority of BellSouth's provisioning activity has occurred in Florida and Georgia, and to date BellSouth has been able to process resale orders for a significant number of end-user accounts.

MCI witness Martinez testified that MCI has experienced problems with BellSouth's bills for resold services, including billing the wrong discount and the wrong rate for call waiting. There are also ongoing disputes over late payment charges for reasons that can be traced back to the inadequacies of BellSouth's own systems. Mr. Martinez also complained that MCI must interact with one group to discuss resale issues (LCSC) and another to discuss billing issues other than resale (ICSC). In addition, he contended that BellSouth should not be found to satisfy its OSS obligation until it has fully implemented CABS for billing of resold services, UNEs, and interconnection.

Mr. Martinez further testified that MCI has identified a number of serious issues regarding BellSouth resale practices. For one, although BellSouth is precluded by contract from using information obtained from MCI's ordering of products and services, MCI discovered during a trial with MCI employees that BellSouth was sending retention letters to customers even before service had migrated from BellSouth to MCI. He stated that because of its ability to control information and timeliness, BellSouth is in a position to engage in discriminatory conduct which will impair the growth of competition. Another problem uncovered in the trial was disconnects of trial participants changed "as is," leaving some without phone service for extended periods of time. He also expressed concerns with BellSouth's interaction with CLP customers. While page 21 of the SGAT states that BellSouth will leave behind generic cards, in trials the BellSouth representative left behind BellSouth cards. Mr. Martinez criticized the requirement that CLPs, upon request, provide proof of authorization to effect a transfer of BellSouth customers. He stated that this, as

well as well as the proposed \$19.41 charge for the unauthorized transfer of a customer—which he said should be much less, as any changes would simply be a name change in CRIS, BellSouth's billing system—sets BellSouth up as the telephone police. Referring to page 23 of the SGAT, which seems to propose that the CLP be the customer of record, Mr. Martinez stated that it was unclear then why BellSouth could not, during test orders, identify the CLP providing service to the customer. He said it was also unclear what is meant at page 22 of the SGAT regarding resale of information, and he complained that the proposed treatment of discontinuance of end user service on page 23 has BellSouth acting as judge and jury for customer problems. Finally, regarding the resale audit proposal on page 30 of the SGAT, Mr. Martinez said such an opportunity should not exist at BellSouth's whim.

Regarding BellSouth's proposal for a charge of \$19.41 for unauthorized changes, Mr. Varner stated that the fee covers such activities as the time BellSouth's service representative is on the phone with the end user, as well as the effort required to switch the customer back and notify the CLP that the customer has been switched back. Regarding BellSouth's proposal for discontinuance of end user service, Mr. Varner noted that there are five points in this section of the SGAT, and for the most part BellSouth is acting on behalf of, or at the request of, the CLP. Only when the CLP fails to take corrective action in the case of annoyance calls originating from an end user's location does BellSouth take the initiative to disconnect.

In response to Mr. Martinez's testimony regarding applying the appropriate discounts, Mr. Milner explained that the source of the problem has been identified and required work in North Carolina is already complete. The ability to apply CLP-specific discount levels was incorporated into Release 97.3 of BellSouth's CRIS system. Rate changes have been, or are being made, and the correct discount levels are being applied. As to the failure to apply the resale discount against non-recurring charges, he stated that this problem has also been identified and appropriate changes to the billing system will correct the problem. Mr. Milner did not agree that BellSouth had billed more than the tariffed rate for call waiting, citing a tariff revision which became effective on July 11, 1997. As to MCI's interaction with the ICSC on billing issues, Mr. Milner stated that the ICSC has received inquiries regarding "contract rates" that required expertise from other groups, but that ICSC service representatives are familiar with the BellSouth-MCI interconnection agreements and have the requisite skills, knowledge, and resources to address CLP requirements. Finally, he stated that all outstanding issues regarding late payment charges had been resolved as of September 10, 1997.

The ability of BellSouth's Operation Support Systems to provide access to unbundled network elements has been addressed under checklist item number 11 above. There the Commission concluded that BellSouth is offering nondiscriminatory access to its OSS systems in accordance with Sections 252(c)(3) and (d)(1) of the Act. We likewise conclude that these systems are able to make BellSouth's services available for resale on

a nondiscriminatory basis, if the CLPs are willing to take advantage of them. Most of the problems discussed by the witnesses can be characterized as start-up problems, and most appear to have been addressed. Other complaints, while understandable, do not rise to the level of evidence that BellSouth is not offering its retail service for resale in compliance with the Act. BellSouth's evidence, on the other hand, shows that it is reselling many of its retail services and that others are functionally available for resale.

Based on the evidence presented, the Commission finds and concludes that BellSouth is providing or generally offering telecommunications services for resale in accordance with the requirements of Sections 251(c)(4) and 252(d)(3) and is in compliance with checklist item XIV.

### THE PUBLIC INTEREST

BSLD witness Taylor testified that the appropriate economic calculation for any public interest analysis entails comparing the potential benefits from entry with the potential risks. He stated that BellSouth entry into the interLATA market in North Carolina would enhance competition, increase consumer choice, advance technological change, and enhance economic efficiency in both interLATA and intraLATA telecommunications. Specifically, he concluded that the benefits of BellSouth entry would include reductions in long distance rates by 25 percent on average, availability of packaged services from a single provider, increased innovation and creation of new products and services, and economies of scope from vertical integration. He further concluded that BellSouth's entry would make it more likely that current long distance companies would enter and compete aggressively in the local and intraLATA markets. On the other hand, he concluded that BellSouth entry would entail no significant risk to competition in the local markets, since theoretical risks are addressed by TA96 and the competitive checklist, and real world experience in similar markets in North Carolina and elsewhere shows that competition is not harmed by the presence of BOC affiliates in competitive markets.

Dr. Taylor testified that competition in the current long distance market – an oligopoly comprising AT&T, MCI, Sprint, and WorldCom with a competitive fringe comprising hundreds of small resellers – is far from fully competitive. This market, he said, has witnessed progressively more stable market shares, a buildup of excess capacity, a reluctance to reduce rates any more than access reductions, and a systematic trend to higher basic rates in recent years. In addition, there has been a distinct pattern of lock-step pricing. Given the difference between prices and costs in the long distance market today, he stated that there is plenty of room for prices to come down despite the existence of excess capacity. Furthermore, since divestiture, large volume users have enjoyed substantial reductions in long distance prices and innovative new service offerings, but small residential customers have not realized benefits to the same degree. Although long distance prices for residential customers have fallen by about 25 percent from 1984 through the beginning of 1994, there has been an 80 percent reduction in rates to the largest business customers.

According to Dr. Taylor, interLATA entry by BOCs where it has occurred has reduced toll prices. For example, as of July 1995, BellAtlantic provided interLATA services to about 10 percent of the customers along the New Jersey - New York and New Jersey - Philadelphia corridors at basic rates that were 20 to 30 percent lower than those of the three largest IXCs. As of July 22, 1996, SNET's prices in Connecticut were 29.8 percent lower than AT&T's for nondiscount customers, 10.6 percent lower for discount customers, and 22 percent lower across all customers. According to one estimate, SNET's market share of the Connecticut long distance market was about 25 percent in September 1996. He calculated benefits from BellSouth entry in North Carolina from a 25 percent price reduction at between \$10.00 and \$11.00 per month per line.

Dr. Taylor explained that the estimated benefits to North Carolina customers arise at two levels. First, a rate reduction is expected to result in bill savings, i.e., savings customers would realize with the same amount of calling. Second, there would be additional value from call stimulation that would follow the 25 percent reduction in rates. The total benefit, he stated, is the cost of the current ineffective long distance competition. Dr. Taylor quantified the total annual benefit and its components under two scenarios. What he called the most likely scenario recognized that the average business rate at 10 cents may be well below the average residential rate at 18.7 cents. The other scenario regarded the average business and residential rates as being the same at 18.7 cents. The 25 percent price reduction due to BellSouth interLATA entry applied to these initial average rates. The annual total benefits ranged from \$365 million to \$424 million under these two scenarios, equivalent to a monthly benefit of between \$8.16 and \$9.48, in North Carolina. Dr. Taylor also identified other benefits from BellSouth's entry, including benefits from packaging local and long distance services estimated to range from \$193 to \$224 million under the two scenarios in addition to the price reduction benefits.

Dr. Taylor further testified that BellSouth's entry into the interLATA market will not harm competition in any market. He stated that any potential problems that may be perceived as a result of BellSouth's status as an incumbent LEC are addressed by the requirement to comply with the competitive checklist and existing FCC and other regulations. In addition, the Act's unbundling, interconnection, and resale requirements will put increasing pressure on BellSouth's access services by ensuring rapid expansion of local exchange competition and continued expansion of exchange access competition and together with regulatory control over access pricing will eliminate any market power BellSouth might otherwise exert over the access market. Dr. Taylor stated that the historical evidence shows that BOCs have not abused their market power or suppressed competition in markets where they have been allowed to compete, such as corridor, cellular, voice messaging service, and intraLATA long distance services. He further stated that there is no threat of a BellSouth interLATA affiliate being able to gain market power and drive efficient competitors from the national long distance market.

With regard to the likelihood that BellSouth would discriminate against long distance competitors through control of the terms and conditions of exchange access, Dr. Taylor stated that BellSouth already faces significant and expanding facilities-based competition

for local exchange services. In addition, the Act requires unbundling of network elements which competitors could use to bypass BellSouth.

BSLD witness Harralson testified that BSLD would enter the interLATA market as a switchless reseller offering basic long distance services, including MTS, WATS, basic 800, calling card services, and operator services to consumers and small businesses and over time would hope to develop a fuller array of services that would be attractive to medium and larger-sized businesses. He stated that BSLD's principal market focus will be the nine-state BellSouth region, but it is exploring targeted out-of-region opportunities and will pursue incidental in-region opportunities if they present themselves. He stated that the correct focus for assessing whether BellSouth's entry into the interLATA market is in the public interest should be whether that entry will have a negative effect on interLATA competition and that competition in the local market should not be assessed, because that is not the market BellSouth seeks to enter. The filing of the SGAT, coupled with comprehensive interconnection agreements with the major carriers, he asserted, satisfies the Act's requirements that the local market be open to competition. The public interest test should not be used to create an additional requirement not intended by Congress.

Mr. Harralson further testified that current conditions make BellSouth's entry into the interLATA market consistent with the public interest. He stated that BellSouth currently has a 0 percent share of the interLATA market in North Carolina and will have to offer high quality service and a competitive price in order to attract customers, both of which it has done on a local and intraLATA basis since 1984. Moreover, he stated that the existing providers who share most of the interLATA market in North Carolina are nationally known and well established providers, who have announced their intentions to compete in the local market, and that it is in the public interest to allow BellSouth the opportunity to offer the same set of local and long distance services as these strong competitors. In addition, he noted that interLATA entry by BellSouth will remove the Act's prohibition against packaging of resold BellSouth local service with interLATA offerings of the largest carriers.

Mr. Harralson further noted that following receipt of interLATA authority BSLD can be in the interLATA market only if it complies with the separate subsidiary and "safeguard" requirements of the Act and the FCC's rules, which are more than sufficient to protect competition. He noted that BellSouth has competed since divestiture in the customer premises equipment, cellular, and other markets without these extreme safeguard requirements, and competition has flourished. Furthermore, the opportunity to discriminate is reduced by BSLD's intended entry as a switchless reseller, i.e., its network will be the facilities of underlying carriers.

From these current conditions, Mr. Harralson stated, the Commission can conclude that BellSouth's full entry into the interLATA market in North Carolina is consistent with the public interest, convenience, and necessity. It will provide consumers with additional choices, while at the same time concerns about BellSouth's anticompetitive behavior are effectively eliminated by the requirements of the Act and the FCC's enforcement powers. Therefore, the potential benefits clearly outweigh any perceived risks.

Regarding nonaccounting and accounting safeguards orders released by the FCC in December 1996, Mr. Harralson stated that Section 272 requirements "kick in" when a



Section 271 application is granted, so there are no requirements with which BSLD is in noncompliance. Mr. Harralson further stated that BSLD believes it will be operationally ready to offer long distance services as a switchless reseller, when the application is granted. It has tested the operational support systems necessary for it to deliver those services and will continue to test them. BSLD's ability to provide service, he stated, depends on the quality of access service provided by the local exchange companies, having its own systems in shape, and quality provision of service of the interexchange carriers.

BSLD witness Raimondi testified that The WEFA Group is a consulting and forecasting organization that has conducted numerous studies on telecommunications and information technology issues. He presented a report prepared by WEFA on the economic impact of permitting BSLD to immediately enter the long distance market in North Carolina. According to Mr. Raimondi, this impact was analyzed by imposing a set of assumptions or adjustments on WEFA's integrated network of econometric models and economic forecasts to generate an alternative forecast called the long distance simulation. Based on higher levels of competition and the resulting increased levels of network utilization, long distance services prices were assumed to fall 25 percent below the baseline forecast for the first five years of the simulation or an additional 5 percent per year. As a result of more competition and lower prices generating enhancements in the network, information services, and technology, productivity gains and quality improvements in the use of information were assumed to average 2 percent more per year in the simulation than in the baseline forecast during the first five years. With lower prices and improvements in the use of information services, the labor force participation rate was assumed to increase 0.5 percent in total over the ten-year forecast interval as employers and employees take advantage of lower costs and higher productivity. The results of this analysis were an additional \$3.2 billion in real gross state product and 34,096 additional jobs spread over all major industry groups over the ten-year forecast interval.

BSLD witness Connaughton testified that he had reviewed the WEFA study and found it overall to be very conservative. He stated each of the three assumptions of the alternative forecast is a conservative estimate. He also stated that the baseline forecast is consistent with recent experience in the North Carolina economy, although it is probably too conservative.

AT&T/MCI witness Kaserman testified that under Section 271 RBOC entry into the interLATA market within its certificated geographic territory is contingent upon the satisfaction of four preconditions. The RBOC must demonstrate that it is providing interconnection to CLPs, one of which is predominantly a facilities-based carrier, or that interconnection is generally available to competitors (the Track A/Track B issue). Terms and conditions under which the RBOC provides interconnection must conform to standards established by a competitive checklist contained in the Act, and the RBOC must also comply with the Act's nondiscrimination and structural separation requirements. The FCC must give substantial weight to the recommendation of the Department of Justice, which may apply any standard it deems appropriate in evaluating a 271 application. And, finally and importantly, the FCC must deny the application unless it finds that the requested entry

is in the public interest. According to Dr. Kaserman, all of these criteria are meant to establish some threshold of competition in the local exchange market as a prerequisite to entry, and the question is what that level of competition should be. His testimony focused on the level of local competition that should exist before interLATA entry and the current level that does exist.

Because the overriding purpose of the Act is to create a pro-competitive, deregulatory environment, Dr. Kaserman stated, the growth of competition must precede the implementation of regulation. He further stated that the merits of effectively competitive markets compared to monopoly markets have been confirmed by economic research, and that the policy that best promotes competition will best serve consumers. Dr. Kaserman asserted that the pertinent issue is whether BellSouth interLATA entry will serve to enhance or impede competition in the affected markets – both long distance and local. He identified three economic principles applicable in addressing this issue:

1. Entry by a firm with substantial monopoly power into an effectively competitive market can lessen competition.
2. Entry by a competitor into a monopolized market unequivocally enhances competition.
3. Entry by a competitor with no monopoly power into an effectively competitive market cannot harm competition.

Dr. Kaserman described effective competition as a situation in which the economic benefits from public policy intervention in a market are more than offset by the economic costs. Furthermore, he stated, one implication of effective competition is that it tends to be irreversible.

Using the framework provided by industrial organization economics, Dr. Kaserman stated that it is inconceivable that the long distance market is characterized by anything other than effective competition in view of the structural characteristics of the market, i.e., the pronounced willingness and ability of customers to switch long-distance providers, the high elasticity of other firms' supply, and the existing distribution of market shares. He also cited empirical evidence, including recent studies of the interexchange industry, to support his view that no firm holds significant monopoly power in the interexchange market and it is therefore subject to effective competition. In addition, Dr. Kaserman noted that the FCC has found that the interexchange market is sufficiently competitive to end AT&T's dominant carrier status.

With regard to RBOC claims of tacit collusion among interexchange carriers, Dr. Kaserman stated that he found the claim unconvincing and unsupported by credible evidence. He described seven structural factors or characteristics of the market which tend to impair the prospects for tacit collusion: low barriers to entry; substantial spare capacity, highly disparate market shares of the largest firms, a relative complex price structure, rapid product innovation, highly skewed distribution of demand, and a very large number of competitors. In addition, Dr. Kaserman identified four aspects of observed conduct and performance which he said are inconsistent with the claim of tacit collusion. These are the downward trend in prices over the past dozen years, the marked instability of AT&T's

market share over time, the presence of aggressive advertising and marketing campaigns of the various long distance carriers, and the consistent propensity and willingness of competitors to expand output. With regard to arguments pointing to recent increases in basic tariffed rates, Dr. Kaserman contended that it would be incredible if the timing and directions of price changes of firms with similar changes in costs, demand, and the like were unrelated. Furthermore, he stated that the widespread use of lower priced ceiling plans makes any analysis based on standard rates suspect, noting that average rates per minute paid for long distance services have been declining for years. In addition, he noted that customers who use undiscounted rates are often low volume users and for some of them the basic tariffed rates do not recover direct costs, so changes in some tariffs are probably best viewed as part of a broad movement in competitive rate restructuring. Finally, he stated that claims of tacit collusion are unbelievable when the scope of the alleged conspiracy is examined in detail. Overall since divestiture large users have enjoyed huge reductions in per minute costs and small users still pay substantially less than they did prior to divestiture. The vast majority of customers have benefited from competition, he stated, and discounted rates are available for consumers who are willing to shop for them.

With regard to charges that the market evidences price leadership, Dr. Kaserman stated that prices charged by rival firms routinely move together in competitive markets, and a high correlation is an indication that consumers view the services provided as close substitutes. He stated that some forms of price leadership, such as when a firm is adept at reading market conditions and calls out a price which other firms routinely follow unless they see profit opportunity from departing from it, are innocuous or even pro-competitive, asserting that only where price leadership promotes collusive, monopolistic prices does the price leadership become an anticompetitive concern.

In contrast to the interLATA long distance market, Dr. Kaserman stated, the local exchange markets in North Carolina exhibit monopoly or near monopoly conditions based on the same criteria: elasticity of other firms' supply, market shares, and conditions of demand. He argued that the speed at which effective competition can be expected to emerge in these markets depends critically on the behavior of BellSouth and response of regulators to this behavior, specifically in the provision of unbundled network elements, interconnection, and wholesale services. He contended that, although the intraLATA toll market appears to be experiencing some competitive growth in certain states and could become effectively competitive in a short time with equal access, access charge reductions, and prevention of BOC exploitation of their local monopolies, the current system is "grossly slanted" to the advantage of the incumbent carriers. He further contended that incumbent providers have taken extensive steps to slow the emergence of effective competition by introducing extended service programs and anticompetitive pricing arrangements. With regard to entry by competitive access providers, Dr. Kaserman stated that the market remains highly concentrated and subject to substantial market power. CAPs are quite specialized, he explained, targeting large companies often located in large buildings, and generally offer dedicated services, both of which limit their competitive impact. They are also relatively small and lack the capacity to offer mass marketed services that would provide most consumers with a realistic alternative to the incumbent

local exchange company. According to Dr. Kaserman, the fact that CAP entry has been limited despite the strong economic incentive to enter the market, demonstrates that significant nonregulatory barriers to entry exist, barriers which apply a fortiori to the local exchange services market where there are tremendous sunk costs and the need for interconnection.

Dr. Kaserman also stated that not only are excessive prices for carrier access service unwarranted on economic grounds, they can do potential damage to the emergence of competition in local exchange markets by providing ILECs a source of excess revenues with which to subsidize anticompetitive practices. He contended that if BOCs are allowed to enter the interLATA market while continuing to receive excess profits from access services, the potential for monopoly leveraging will be expanded significantly.

The local exchange markets, Dr. Kaserman stated, are the least competitive of all, and, for residential customers, choice is practically nonexistent. ILEC market shares are at or near 100 percent in many markets and entry barriers are sufficiently high to allow monopolistic pricing without substantial threat of response from potential competitors. He attributed this situation to the fact that competitive entry requires the cooperation of BellSouth contrary to BellSouth's economic interest. In addition, cost conditions and investment requirements severely limit entry, especially on a facilities basis. Finally, certain local exchange rates may incorporate subsidies.

With regard to whether the local exchange markets are open to competition, Dr. Kaserman stated that there is no precise meaning to this term but that the closest related concepts are market "contestability" and low barriers to entry. In other words, a market with no sunk cost of entry that allows for rapid entry and zero-cost exit is contestable. In such a market, potential competition plays the same role as actual competition in limiting the exercise of market power. Low barriers to entry play a similar role. He stated that neither condition is present in the local service markets in North Carolina. He further stated that the argument that BellSouth has opened its markets to competition because regulatory barriers to entry have been removed and BellSouth has satisfied the competitive checklist is a purely legal claim.

Dr. Kaserman also discussed the theory of monopoly leveraging and the four most familiar categories of leveraging strategies: tying arrangements or bundling, vertical price squeezes, price discrimination, and service or quality discrimination. He contended that the entry of a regulated local exchange company into long-distance markets while still enjoying monopoly power in its local exchange markets provides an especially attractive environment for such strategies. He further contended that the markets under consideration in North Carolina exhibit two important structural characteristics that greatly increase the scope for leveraging. One is BellSouth's inability to fully exploit its local monopoly through unrestricted pricing of access, which increases the profitability of leveraging through tying or other means. The other is consumer preferences for bundled services, which makes it unnecessary to force them to take the tied product. Other market characteristics that facilitate monopoly leveraging, Dr. Kaserman stated, are the current overpricing of access service and the lack of competition in the local exchange markets. He cited independent economic analyses of leveraging under price regulation in support

of his contention that leveraging strategies are plausible in circumstances similar to those that currently prevail in telecommunications markets, and he contended that if BellSouth were allowed to reintegrate into in-region interLATA markets, circumstances similar to anticompetitive behavior in the past would rise again. Furthermore, Dr. Kaserman argued, regulatory mechanisms such as price caps and imputation tests cannot prevent leveraging.

In addition to the emergence of incentives for monopoly leveraging, according to Dr. Kaserman, the likely consequences of BellSouth entry into the interLATA market at this time are the perversion of the normal desire to displace rivals and the erosion rather than the promotion of competition in both the interLATA market and the local exchange market. He noted that divestiture removed the incentive for RBOC to engage in monopoly leveraging behavior with respect to the interLATA market, which greatly aided the emergence of healthy competition in that market, but that RBOCs have subsequently engaged in practices designed to forestall competition in areas where it has had the potential to develop.

Dr. Kaserman stated that because of consumer preferences for bundled service offerings, IXC entry into local exchange markets will greatly intensify incentives for RBOCs to reenter long distance and to facilitate whatever level of competition is required under Section 271 to permit their own reintegration. But, he contended, if RBOC long distance entry is allowed to proceed without sufficient entry into local exchange markets, their incentive to facilitate competition is lost and their incentive to maintain their monopoly positions is heightened. He also stated that to the extent bundling can benefit customers, its full benefit can only be realized if interexchange carriers are able to offer bundled service as rapidly as possible and RBOCs are prohibited from doing so until local markets are effectively competitive. According to Dr. Kaserman, if the ILEC becomes a long distance provider while maintaining its monopoly status, it automatically becomes the monopoly provider of the bundled service and, to the extent it can, extracts a substantial portion of bundle-created benefits from consumers, while the IXCs are not monopolies in any market. Thus, IXC entry into the local market will assure that consumers receive the full benefits created by offering bundled services.

With regard to the WEFA analysis, Dr. Kaserman stated that it is not a statistical study in the conventional sense but a complex simulation driven entirely by the assumptions applied. The assumptions used by BellSouth, he contended, are unrealistic, unsupported by credible evidence, and contradictory with BellSouth's own positions. Specifically, Dr. Kaserman said, the assumption that BellSouth entry will generate a 25 percent across-the-board price reduction is unsupported by any statistical evidence or theoretical analysis. Furthermore, Dr. Kaserman stated, the WEFA analysis does not address the most vital issue in the 271 process, the promotion and facilitation of local exchange market competition, because it assumes that prices and service quality in local markets are not dependent on whether BellSouth is allowed to enter the long distance market and his testimony shows that an important consequence of BellSouth entry is the elimination of incentives to cooperate in promoting local exchange competition.

Finally, Dr. Kaserman stated that regulators must put in place as soon as possible the competition-enabling policies of the Act and closely monitor the development of competition in the local exchange markets.

AT&T/MCI/CompTel/WorldCom witness Gillan testified that because BellSouth's interLATA opportunity is immediate and ubiquitous, the Commission must be absolutely convinced that local exchange markets are competitive and that the checklist is operational before BellSouth is allowed to enter the long distance market. Mr. Gillan stated that the most likely consequence of the removal of BellSouth's interLATA restriction is the reintegration of the local and long distance markets and that the combined effects of a market preference for one-stop shopping and BellSouth's full participation as a one-stop provider will have a lasting effect on the structure of the industry. Therefore, he stated, local service must become competitive or full service competition will never be a reality, and BellSouth cannot be permitted to offer interLATA long distance services unless others can just as easily offer local services and compete.

Mr. Gillan further testified that BellSouth's own economic witness, Dr. Taylor, had admitted in another proceeding that BellSouth need not offer lower prices to attract customers because it can attract them as a one-stop provider. He stated that consumers benefit only if other carriers have the ability to compete as one-stop providers with lower prices themselves, which depends on access to network elements and combinations. Mr. Gillan also stated that barriers to entry in the local market are not comparable to those that once existed in long distance.

AT&T/MCI witness Cabe testified that Section 271 of the Act generally and the competitive checklist specifically requires a determination that there is meaningful competition in the local exchange market in the area served by the BOC and that all fourteen items of the checklist have been met. Dr. Cabe stated that both the development of full and robust competition for local services and the preservation of competition for long distance services will provide benefits for end users and are contemplated by the Act. Because of differences in the two markets, however, including the level of monopoly power exercised by the ILECs and the disparity in the levels of investment needed to enter each market, the Act mandates that local competition must develop before BOC entry into the interLATA long distance market is permitted. Dr. Cabe asserted that if BellSouth is permitted to enter the interLATA market before effective competition has developed in the local market, it is likely that local competition will never develop and that long distance competition will be reduced or eliminated. He stated that until effective competition exists for local bottleneck facilities, BellSouth retains the ability to leverage monopoly control into the long distance markets, asserting that, if BellSouth were allowed to enter the interLATA market today, it could do so with little additional investment of its own, while companies seeking to enter the local markets face a very different environment. Other consequences of permitting BellSouth interLATA entry prematurely, according to Dr. Cabe, include diminishing BellSouth's motivation to cooperate with potential providers in order to resolve technical and operational issues.

In response to the IXCs' position, Dr. Taylor testified that the public interest analysis must stay rooted in the supply of in-region interLATA services. He further stated, however,

that even if it were appropriate to examine the local exchange market, the effects there of BellSouth's entry will not be negative. Dr. Taylor also stated that the Act allows interLATA entry upon compliance with the competitive checklist, and there is no requirement that actual facilities-based competition be present. Furthermore, he stated that BellSouth's entry will deliver significant benefits to long distance customers for two reasons: it will likely reduce long distance prices, and the ongoing requirements of the Act to retain in-region interLATA authority and the prospect of packaging local and long distance services will safeguard any attempt by BellSouth to act anti-competitively.

Regarding the present state of competition for interLATA service, Dr. Taylor stated that the number of long distance firms is not evidence per se of vigorous competition particularly when the majority are resellers of services provided by four facilities-based providers who account for 88 percent of presubscribed lines and over 84 percent of toll revenues. He further stated that while AT&T's market share declined from over 90 percent around divestiture to below 53 percent in 1996, most of the share lost by AT&T has been gained by MCI and Sprint, leaving little share growth for the hundreds of resellers in the industry. The real test of competition, he stated, is whether market prices move in the direction of their corresponding costs, and the trend observed in recent years of rising basic long distance rates, when viewed in the context of stagnant market shares and declining access costs, can only suggest that some form of tacit price coordination has been occurring in the market. Regarding Dr. Kaserman's argument that average rates per minute have been declining, he stated that during the period for which the ARPM was calculated discounted prices were available to less than half of North Carolina customers, that ARPM is a misleading index of price movements, and the argument does not acknowledge the significant contribution of access rate reductions to lower prices and instead attributes those lower prices to competition.

Dr. Taylor further testified that other evidence of long distance competition offered by the IXC witnesses is not credible. He stated that the relative growth of resellers is evidence that the facilities-based carriers have priced their retail services substantially above costs. Moreover, the argument that the long distance market has significant excess transmission capacity which deters any single firm from raising its prices above competitive levels is inconsistent with the kinds of price-cost margins observed in long distance market, which is a clear indicator of the price elevating property of excess capacity when used collectively. He also stated that the rapid growth of output of AT&T's competitors is not an indicator of intense competition but is determined by reduction of AT&T's market share as a result of its having erected a price umbrella over its competitors and industry growth which is fully explained by price changes and income growth. There is, he asserted, no residual growth attributable to stimulation of demand resulting from new service offerings. Furthermore, switching behavior of consumers is not necessarily an indicator of intense competition. While there are high volume customers to whom IXCs aggressively market their services, there is no indication that a substantial segment of low volume customers readily switch carriers in response to small price changes. Finally, Dr. Taylor stated that he was not persuaded that the seven structural factors cited by Dr. Kaserman support his claim that no form of tacit price coordination exists in the interLATA market.

With regard to his testimony in Louisiana, cited by Mr. Gillan, Dr. Taylor stated that it was and is that if allowed BellSouth will enter the interLATA market by offering its customers who already do business with BellSouth an opportunity to save on long distance calls. While initially BellSouth may not have to offer a high discount rate to attract long distance customers, IXCs will have to respond with price reductions, and the overall average market price reductions from these events will be about 25 percent.

With regard to the effect of BellSouth's entry on competition in the local exchange market, Dr. Taylor stated that the checklist requirements will not go away and the incentive to comply will likely become greater as the opportunity cost of not staying in compliance increases. Furthermore, he stated his belief that BellSouth would not be able to impede local competition because of ongoing regulatory oversight, structural separation requirements, and other competitive safeguards.

Dr. Taylor further stated that, contrary to the assertions of the IXC witnesses, the degree of competition in the local market is irrelevant to whether BellSouth will act anticompetitively. The theory of the Act is that interLATA entry cannot be anticompetitive when IXCs have alternatives to RBOC carrier access services for originating and terminating their traffic, and the availability of those alternatives has no necessary relationship to the degree of competition in the local exchange market. Dr. Taylor denounced the suggestion that effective competition in the local exchange market must precede interLATA entry and stated that equalization of the levels of competition is the outcome of establishing competitive parity, not its prerequisite. He rejected Dr. Kaserman's attempts to draw an analogy between BellSouth today and the vertically integrated AT&T prior to divestiture, pointing out that BellSouth today faces IXCs with enormous resources, expertise, and staying power in both local and long distance markets. With regard to the contention that sunk costs are central to the prospects for local competition, Dr. Taylor stated that while the prospect of having to incur these costs can prove daunting to potential entrants, the prediction that this will be an entry barrier can be misleading for several reasons. Furthermore, recognizing that the sunk costs of a new entrant can be prohibitive, the Act's requirements about unbundling, nondiscrimination, and resale are designed to lower those sunk costs and allow entrants to enter the market with fewer irreversible investments.

Dr. Taylor also rejected allegations that BellSouth's interLATA entry will likely result in monopoly leveraging. With regard to examples cited by Dr. Kaserman of monopoly leveraging by RBOCs in the divestiture era, Dr. Taylor stated that it is worth taking note of the remarkable lack of competitive abuses and the good performance of the many markets in which the RBOCs have competed. He also asserted that, given the requirements of the Act and the more fully developed regulatory policies in place with regard to treatment of competitors, the possibility of such disputes is more remote now.

Regarding Dr. Kaserman's assertions that BellSouth should be denied interLATA entry until there is effective competition in the local exchange market, Mr. Harralson stated that the Act contains no such standard or other competition threshold requirement. Indeed, he noted that Congress considered and rejected arguments that some market share loss



or effective or substantial competition standard should be a condition of entry and instead chose to rely on the competitive checklist and special safeguards.

In response to Mr. Gillan's arguments that entry into the local exchange market is difficult compared to entry into the long distance market, Mr. Harralson stated that the regulatory requirements for BellSouth to enter the interLATA market are unique and burdensome and there are also marketing hurdles to overcome.

Mr. Varner stated that there are two reasons why it is important for this Commission to act now in making its determination that BellSouth's interLATA entry is in the public interest. A positive response will hasten the day when consumers in North Carolina will see the benefits of increased long distance competition, and it will likely accelerate the development of local competition as well. According to Mr. Varner, the appropriate focus of this determination should be the benefits to be gained by customers in the interLATA market. Congress, he stated, determined that local competition was in the public interest and specified through Sections 251, 252, and 271 of the Act a set of criteria which, when met, would ensure that the public interest had been met in the local market. Since Congress specified no such criteria for the interLATA market, BellSouth believes the Commission should focus on the benefits customers will gain when the interLATA market is opened to additional competition. These benefits, Mr. Varner stated, will be immediate and tangible. BellSouth entry will reduce the ability of interexchange carriers to engage in lock step pricing by increasing the number of effective facilities-based competitors, the diversity of cost characteristics, the diversity of product mix, and the rate of technological change. Consumers will benefit as companies are able to use existing facilities to supply additional services. They will also benefit by being able to obtain bundled services from BellSouth and other providers. Moreover, Mr. Varner stated, allowing BellSouth to offer a full range of services to its customers will be a powerful stimulus for the IXCs to do the same by entering the local market more quickly and with greater intensity.

Mr. Varner stated that the public interest criteria set forth by the intervenors ignore the requirements of the Act and assert various principles that were debated and rejected by Congress. In the Act, Congress specifically identified what it required of BellSouth before interLATA entry could be sought: that BellSouth open its local markets to competition in accordance with specific criteria. Thus, the requirements which are the public interest criteria for the local market are identified in the Act. Not only did Congress establish appropriate standards to determine interLATA entry, it also established a prohibition against imposing additional criteria. Moreover, Congress did not specify a set of requirements for determining public interest in the long distance market. Therefore, he asserted, the focus of the public interest determination in this proceeding should be the benefits to be gained by consumers in the interLATA market.

Mr. Varner further stated that as a policy matter the Commission should not delay BellSouth's entry as proposed by the intervenors, because the public will be best served by allowing the maximum number of choices of providers for all services. As to BellSouth's incentive to continue the development of local competition once it is in the interLATA long distance business, Mr. Varner responded that BellSouth is legally obligated to comply with the requirements of the Act, particularly Sections 251 and 252, and must continue to